98TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPORT 98-853

SMALL BUSINESS SECONDARY MARKET IMPROVEMENT ACT OF 1984

JUNE 21, 1984.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. MITCHELL, from the Committee on Small Business, submitted the following

REPORT

[To accompany H.R. 4773]

[Including cost estimate of the Congressional Budget Office]

The Committee on Small Business, to whom was referred the bill (H.R. 4773) to amend the Small Business Act to assist in the creation of a secondary market for the portions of loans guaranteed by the Small Business Administration, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. This Act may be cited as the "Small Business Secondary Market Improvements Act of 1984".

SEC. 2. Section 5 of the Small Business Act is amended by adding at the end thereof the following new subsections:

"(f)(1) The guaranteed portion of any loan made pursuant to this Act may be sold by the lender, and by any subsequent holder, consistent with regulations on such sales as the Administration shall establish, subject to the following limitatons:

"(A) prior to the Administration's approval of the sale, or upon any subsequent resale, of any loan guaranteed by the Administration, if the lender certifies that such loan has been properly closed and that the lender has substantially complied with the provisions of the guarantee agreement and the regulations of the Administration, the Administration shall review and approve only materials not previously approved;

"(B) all fees due the Administration on a guaranteed loan shall have been paid in full prior to any sale; and

"(C) each loan shall have been fully disbursed to the borrower prior to any sale.

"(2) After a loan is sold in the secondary market, the lender shall remain obligated under its guarantee agreement with the Administration, and shall continue to service the loan in a manner consistent with the terms and conditions of such agreement.

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"(3) The Administration shall develop such procedures as are necessary for the facilitation, administration, and promotion of secondary market operations, and for assessing the increase of small business access to capital at reasonable rates and terms as a result of secondary market operations.

"(4) Nothing in this subsection or subsection (g) of this section shall be interpreted to impede or extinguish the right of the borrower or the successor in interest to such borrower to prepay (in whole or in part) any loan made pursuant to section 7(a) of this Act or to impede or extinguish the rights of any party pursuant to sections 3(e), 7(a)(6), or 7(a)(8).

"(g)(1) The Administration is authorized to issue trust certificates representing ownership of all or a fractional part of the guaranteed portion of one or more loans which have been guaranteed by the Administration under this Act, except those under section 7(a)(13): *Provided*, That such trust certificates shall be based on and backed by a trust or pool approved by the Administration and composed solely of the entire guaranteed portion of such loans.

"(2) The Administration is authorized, upon such terms and conditions as are deemed appropriate, to guarantee the timely payment of the principal of and interest on trust certificates issued by the Administration or its agent for purposes of this subsection. Such guarantee shall be limited to the extent of principal and interest on the guaranteed portion of loans which compose the trust or pool. In the event that a loan in such trust or pool is prepared, either voluntarily or in the event of default, the guarantee of timely payment of principal and interest on the trust certificates shall be reduced in proportion to the amount of principal and interest such prepaid loan represents in the trust or pool. Interest on prepaid or defaulted loans shall accrue and be guaranteed by the Administration only through the date of payment on the guarantee. During the term of the trust certificate, it may be called for redemption due to prepayment or default of all loans constituting the pool.

"(3) The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guarantee of such trust certificates issued by the Administration or its agent pursuant to this subsection.

"(4) The Administration shall not collect any fee for any guarantee under this subsection: *Provided*, That nothing herein shall preclude any agent of the Administration from collecting a fee approved by the Administration for the functions described in subsection (h)(2).

"(5)(A) In the event the Administration pays a claim under a guarantee issued under this subsection, it shall be subrogated fully to the rights satisfied by such payment.

"(B) No State or local law, and no Federal law, shall preclude or limit the exercise by the Administration of its ownership rights in the portions of loans constituting the trust or pool against which the trust certificates are issued.

"(h) Upon the adoption of final rules and regulations, the Administration shall—

"(1) provide for a central registration of all loans and trust certificates sold pursuant to subsections (f) and (g) of this section. Such central registration shall include, with respect to each sale, an idenification of each lender who has sold the loan; the interest rate paid by the borrower to the lender; the lender's servicing fee; whether the loan is for a fixed rate or variable rate; an identification of each purchaser of the loan or trust certificate; the price paid by the purchaser for the loan or trust certificate; the interest rate paid on the loan or trust certificate; the fees of an agent for carrying out the functions described in paragraph (2) below; and such other information as the Administration deems appropriate;

"(2) contract with an agent to carry out on behalf of the Administration the central registration functions of this section and the issuance of trust certificates to facilitate pooling. Such agent shall provide a fidelity bond or insurance in such amounts as the Administration determines to be necessary to fully protect the interest of the Government;

"(3) prior to any sale, require the seller to disclose to a purchaser of the guaranteed portion of a loan guaranteed under this Act and to the purchaser of a trust certificate issued pursuant to subsection (g), information on the terms, conditions and yield of such instrument. As used in this paragraph, if the instrument being sold is a loan, the term 'seller' does not include (A) an entity which made the loan or (B) any individual or entity which sells three or fewer guaranteed loans per year; and

"(4) have the authority to regulate brokers and dealers in guaranteed loans and trust certificates sold pursuant to subsections (f) and (g) of this section.".

SEC. 3. (a) Within ninety days after the date of enactment of this Act, the Small Business Administration shall develop and promulgate final rules and regulations to implement the central registration provisions provided for in section 5(h)(1) of the Small Business Act, and shall contract with an agent for an initial period of not to exceed two years to carry out the functions provided for in section 5(h)(2) of such Act.

(b) Within nine months after the date of enactment of this Act, the Small Business Administration shall consult with representatives of appropriate Federal and state agencies and officials, the securities industry, financial institutions and lenders, and small business persons, and shall develop and promulgate final rules and regulations to implement this Act other than as provided for in subsection (a).

(c) The Small Business Administration shall not implement any of the provisions under section 5(g) of the Small Business Act, as amended, until final rules and regulations become effective.

SEC. 4. Section 10 of the Small Business Act is amended by adding at the end thereof the following new subsection:

"(h) The Administration shall transmit, not later than March 31 of each year, to the Committees on Small Business of the Senate and House of Representatives a report on the secondary market operations during the preceding calendar year. This report shall include, but not be limited to, (1) the number and the total dollar amount of loans sold into the secondary market and the distribution of such loans by size of loan, size of lender, geographic location of lender, interest rate, maturity, lender servicing fees, whether the rate is fixed or variable, and premium paid; (2) the number and dollar amount of loans resold in the secondary market with a distribution by size of loan, interest rate, and premiums; (3) the number and total dollar amount of pools formed; (4) the number and total dollar amount of loans in each pool; (5) the dollar amount, interest rate, and terms on each loan in each pool and whether the rate is fixed or variable; (6) the number, face value, interest rate and terms of the trust certificates issued for each pool; (7) to the maximum extent possible, the use by the lender of the proceeds of sales of loans in the secondary market for additional lending to small business concerns; and (8) an analysis of the information reported in (1) through (7) to assess small businesses' access to capital at reasonable rates and terms as a result of secondary market operations.".

SEC. 5. Section 4(c)(1)(B) and section 4(c)(2)(B) of the Small Business Act are each amended by inserting "5(g)," immediately after the word "sections".

SEC. 6. This Act does not authorize the appropriation of any funds.

PURPOSE OF THE BILL

This legislation, H.R. 4773, is intended to provide specific statutory authority for a Small Business Administration program for the sale of the government guaranteed portions of SBA 7(a) business loans to investors through a Secondary Market Program, and to expand that concept to sales of trust certificates representing interests in large pools of such loans.

The bill, H.R. 4773, would continue, and improve, the present Secondary Market Program, which has been operating successfully for several years on an administrative basis but which has not reached its full potential to assist small business. Moreover, it would establish by statute a new, expanded Secondary Market Program: the bill authorizes sale of the guaranteed portion of SBA 7(a) loans by lenders or holders to broker/dealers and others for the purpose of subsequent pooling and sale to investors of government guaranteed trust certificates representing all or part of an interest in the pool. These trust certificates would carry the necessary Government guarantee of timely payment of principal and interest needed to attract increased numbers of investors. Pooling would provide increased liquidity to lenders.

The legislation would accomplish dual goals of enlarging the supply of funds made available to the small business community and reducing the cost of those funds. It also would provide a method for using the secondary market to increase availability of fixed rate financings which so many small concerns see as vital to their survival in this economy.

Introduction and Background

Representative Henry J. Nowak on February 7, 1984, introduced H.R. 4773, a bill to amend the Small Business Act to assist in the creation of a secondary market for the portions of loans guaranteed by the Small Business Administration. There are currently 43 cosponsors. The bill was referred to this Committee's Subcommittee on Tax, Access to Equity Capital and Business Opportunities.

As part of its study of the capital formation process, the Subcommittee held an investigatory hearing on SBA secondary market activities on September 28, 1983. Acting on that investigation, Mr. Nowak introduced H.R. 4773 with the objective of facilitating an expanded secondary market for SBA guaranteed loans and providing more capital to small business borrowers. The Subcommittee held hearings on H.R. 4773 on February 29, 1984.

Testimony was received at these two hearings from SBA Administrator James C. Sanders, banking executives, securities and investment specialists and other interested parties. Throughout its investigation and hearings on increasing access to capital for small concerns, the Subcommittee received and carefully analyzed numerous reports, data and other investigative materials supplied by public and private sector sources.

At its mark up session of June 7, 1984, the Subcommittee ordered the bill reported, as amended, by a unanimous vote of those Members present. On June 19, 1984, the full Committee marked up H.R. 4773, and an amendment in the nature of a substitute was ordered reported by the full Committee by a unanimous vote of those Members present.

Need for the Legislation

Because small business is the Nation's leader in job creation, productivity, and innovation and research, it deserves, and must have access to debt capital at reasonable rates. Small and minority concerns and entrepreneurs are at a disadvantage in obtaining conventional financing, especially in times of record high interest rates. Recently, wide-spread attention to this problem has generated recommendations for assistance from both the Legislative and Executive Branches.

In 1982, the Small Business Administration appointed a task force known as the Small Business Committee on Capital Access, which had the responsibility of making recommendations to increase the small business community's access to capital markets and to reduce its borrowing costs. To make SBA's 7(a) business loan quarantee program more effective, that Committee recommended encouraging development of the secondary market for sale of guaranteed portions of pooled SBA loans to attract greater participation from major financial institutions. The Committee believed that this increased involvement in the purchase of these loans and resulting competition

among lenders to make 7(a) guaranteed loans for resale in the secondary market would both increase the loan funds made available to small businesses and lower the cost of those funds to the borrower.

In 1983, the General Accounting Office (GAO) issued a report to Congress entitled "SBA's 7(a) Loan Guarantee Program: An Assessment of its Role in the Financial Market", in which GAO concluded not only that the SBA 7(a) guaranteed loan program helps lenders fill a critical credit gap for small businesses needing long term financing but also that the current SBA secondary market program for these loans has advantages for both lenders and small businesses. The GAO found that it helps lenders with liquidity problems to make loans to small businesses that otherwise would not be made; and it enables lenders to leverage capital and make more small business loans than otherwise would be possible.

GAO endorsed the potential benefit of the secondary market program to small businesses:

> Lenders are able to obtain funds from investors such as insurance companies, pension funds, and money market funds which traditionally do not invest directly in small business. For some small banks, being able to gain access to these pools of managed capital is the difference between being able or unable to make an SBA-guaranteed loan. The secondary market process also has a leveraging effect, allowing lenders to reinvest the proceeds from sales in other small businesses. Lastly, the secondary market is used by some lenders to offer borrowers (1) the stability of fixed rate instead of variable rate loans and (2) lower interest rates.

As part of its recommendations to SBA to improve the effectiveness of the secondary market program, GAO specifically recommended that SBA develop a strategy for using the secondary market to offer small businesses the option of fixed rate financing, and that part of this strategy should address the desirability of actions such as the use of loan pooling.

In order for the financial programs presently administered by SBA to supply the needed financing to small business concerns, a broad base of financial institutions and investors must be induced into the process of financing small concerns.

At the present time, the great majority of SBA financing for small business is being accomplished in conjunction with the commercial banking system through the 7(a) guaranteed loan program. There are occasional shortages of loan funds due to periodically restrictive nonetary policy or excessive demand for funds from all sectors. Partially through evolution and partially as the result of development by SBA and private sector participants, a system has been established whereby lenders, mostly banks, sell the SBA guaranteed portions of small business loans through a secondary market to private investors. This process generates new funds for small business, and permits banks to recycle funds to be made available for additional small business lending. Currently this system accounts for the availability of about $600 million for small business lending annually.

Your Committee believes that this system needs to be bolstered if it is to continue to be successful. There is a need not only to broaden the

base of secondary market investors in small business loans, but also to increase the base of small business lenders and servicers who participate in the secondary market so that the delivery system contains competitive factors which insure efficiency. The present secondary market system was developed without explicit statutory authority to develop or maintain a secondary market in SBA guaranteed loans.

The Committee is convinced that legislation to provide that specific authority and also to authorize SBA to establish a new pooling arrangement and to issue certificates for sale to investors which would represent the guaranteed portions of 7(a) loans is necessary. Such certificates, to be marketable, must be fully guaranteed (by the United States) as to the timely payment to the purchasers of both principal and interest.

THE PRESENT SBA SECONDARY MARKET PROGRAM

The Small Business Administration, since its inception in 1953, has issued loan guarantees to induce lending institutions to finance small businesses. Each guaranty may cover no more than 90 percent or $500,000 of a qualified small business borrower's obligation.

SBA's Secondary Market Program, launched in 1973, enables lenders to sell the guaranteed portions of the loans they make. By selling the guaranteed portion, the lender immediately recoups most of its disbursement and can also increase the yield on the unguaranteed portion by charging the purchaser a continuing fee for servicing the entire loan.

SBA guaranteed portions, or "GP's", stand up favorably against other intermediate-term investments. Backed by the full faith and credit of the U.S. Government, the average fixed-rate SBA GP has a term of seven to ten years.

Although SBA loan sales have grown from $60 million in 1973 to over $600 million, many cash-rich institutional investors have been reluctant to invest in SBA GP's, citing the time-consuming sales procedures, the confusing ownership documentation and the unpredictable collection of payments.

SBA has acted to remedy these difficulties by appointing a Fiscal and Transfer Agent (FTA) to make it simpler for investors to manage a large portfolio of SBA GP's and for lenders to service the GP's they sell.

The main features of the present fiscal and transfer agency arrangements are:

(1) a Guaranteed Interest Certificate as evidence of ownership of the entire guaranteed portion of an SBA 7(a) loan. Under this system only individual loans are brought and sold;

(2) a central fiscal agency paying system. Lenders using the FTA make payments on all their SBA loans with a single check to the FTA and registered holders of certificates receive payments on all their certificates in a single check from the FTA; and

(3) a central transfer agency and registry. Following certificate issuance, the FTA facilitates the orderly flow of funds from the lender-servicer in the program to the registered holder of each certificate.

The lender-servicer charges an ongoing servicing fee which is deducted from each payment. This fee is negotiated by the lender-servicer and the dealer when each loan is brought to market. The lender-servicer must pay the SBA an up-front guaranty fee equal to 1% of the guaranteed principal.

However, under the present system SBA does not guarantee "timely payment" of principal and interest. If a borrower's payment is uncollected by the FTA, the agency is not required to pay the investor, although under the current practice the FTA does, on an interim basis, pay the investor anyway. When a loan is past due for 60 days or more, the FTA initiates default proceedings to recover principal and accrued interest from the lender-servicer or SBA. The FTA will notify the registered holder of this pending action. At any time during the term of the certificate it may be called for redemption due to normal or accelerated repayment, prepayment in full, or default.

This secondary market program for individual sales has proved useful and should be retained. However, it is not equal to the task of facilitating increased participation of lenders to small business providing increased liquidity to attract investors. There is ample evidence that more needs to be done to provide capital to small concerns. For instance, there is a continuing problem that SBA does not utilize all of its guarantee authority. Figures for recent years show:

[In billions of dollars]

	Congressional appropriation	Annual SBA guarantee utilization
Fiscal year:		
1981	3.7	2.84
1982	2.6	1.5
1983	2.5	2.0
1984	2.6	[1] 2.1

[1] Estimated.

The administration's future budget recommendations for SBA guaranteed loan commitments are declining for each of the next 5 years in contravention of Congress' expressed convictions. By improving the SBA secondary market operations, the Committee hopes to make the guaranteed loan program more attractive to banks and reaffirm Congressional support for loan levels at least as high as current authorizations in the Small Business Act.

By offering larger units in the secondary market, in contrast to the current method whereby the guaranteed portion of an individual loan is sold to the investor, SBA could induce major financial institutions to become more active in originating and purchasing SBA guaranteed loans. Ultimate costs borne by small business borrowers are expected to decrease. The availability of fixed-rate financing would increase. Secondary market demand increases could yield lower rate-of-return requirements from investors.

The objective of packaging SBA loans into homogeneous pools is to enhance their liquidity in the secondary market and thereby attract ready monies for the nation's small business at the lowest possible cost. To date, institutional investors have been unwilling to com-

mit substantial funds to SBA guaranteed loans due to the lack of uniformity among these loans, the comparatively small size of such loans (the average SBA guaranteed loan is significantly below $200,000) and the relative illiquidity of the secondary market. Pooling provides a mechanism for creating homogeneous securities which would have greater appeal in the national capital markets among institutional investors. Access to institutional investors would result in significantly lower borrowing costs.

To reduce the cost of financing SBA guaranteed loans, a financial vehicle must be created which is negotiable. Pooling has been successfully used in the housing markets for government guaranteed mortgage pools of government insured mortgages and mortgage pools of conventional uninsured mortgages. A similarly successful program is needed for small business financing.

Investment bankers believe SBA would obtain similar success if it were to pool its loans and issue securities representing fractional undivided interests in such pools. By creating a liquid security, which would appeal to institutional investors, it is anticipated that small businesses would be able to obtain funds at fixed interest rates and at significantly lower costs than under the present structure.

What the Bill Would Do

The legislation would retain the option for the individual sales by lenders and holders of SBA 7(a) guaranteed loans by giving a statutory base for SBA's present program, the aforementioned present secondary market program. The cornerstone of the bill, H.R. 4773, is the new secondary market for government guaranteed certificates representing pooled SBA guaranteed loans.

THE NEW POOLING ARRANGEMENT

Under the new pooling arrangement which H.R. 4773 would provide as an amendment to the Small Business Act, SBA would be permitted to take such steps as are necessary to facilitate the functioning of a secondary market in the SBA guaranteed portions of loans made by banks and other lending institutions. In this regard it would permit SBA, or its agent, to issue certificates which represent the SBA guaranteed portions of the loans. The certificate would be backed by the full faith and credit of the United States and SBA would guarantee the "timely payment of principal and interest" on the trust certificates. It also would provide authority for the sale of certificates of interest in pools of these guaranteed portions in the secondary market, and for SBA to take whatever steps are necessary to facilitate these sales.

Broker/dealers could submit loan pools to SBA for review and, subject to approval, SBA could interpose its full faith and credit guarantee on the actual securities. This method would be similar to the GNMA origination process wherein approved mortgage bankers submit goods of FHA/VA loans to GNMA for its full faith and credit guarantee.

The bill would require SBA to appoint an agent to serve as the central registry recording for all sales and resales of individual SBA guaranteed loans and trust certificates in the secondary market. Such

an agent would receive payment on all individual loans from the originating lenders and remit these payments to the holders. This agent would retain a fee for performing this service.

The agent, under rules and regulations to be established by SBA, also would issue trust certificates representing pools of loans (on behalf of SBA) and administer the pools. The agent would hold the individual loans for investors who would own shares in the pool of loans. The agent would charge only such fees as are necessary to cover expenses directly related to the administration and servicing of the pools. The agent would receive payments on individual loans and make the appropriate payment when due on the pool certificates to investors. In cases of delayed payments by borrowers or lenders on individual loans, the agent still would continue to make timely payments to pool investors, covering the shortfall from its fees and any payments received. SBA would guarantee timely payment to investors as per agreement with this agent and honor its guarantee on ultimate default on any loan in the portfolio.

The SBA ultimately would be responsible for covering shortfalls in the pooling arrangement. However, the Committee anticipates that funding the guaranteed timely payments could be structured so there would be no additional budgetary impact, since the guarantee of the trust certificates is basically only a "secondary" guarantee (the agency is already obligated for the amount of the pooled loan and the only additional exposure is the "timely" guarantee which is another way of saying that the SBA will pay interest on late payments). A fidelity bond would protect the interest of the government from default by the agent. SBA would contract with its agent to administer the pools and promulgate rules and regulations under which the market would operate. SBA would be responsible for approving individual pools and promulgation rules and regulations with respect to pools.

In the event that a loan in a trust or pool is prepaid by the borrower, the holders of the trust certificates or other securities would receive pass-through of payments in proportion to their share of ownership in the pool. The pool, and the guarantee of timely payment of interest and principal would then be reduced in proportion to the amount the prepaid loan represents in the trust or pool.

In a similar manner, if a payment on a loan in a pool is delinquent for more than a given length of time (to be determined by contract between the SBA and its agent) the SBA would repurchase the loan from the pool investors, with the size of the pool reduced accordingly.

Under the provisions of the new legislation, SBA would be responsible for a central registration of all loans and trust certificates sold which will provide necessary information to assist in monitoring secondary market operations.

The small business borrower receiving the SBA 7(a) guaranteed loan would continue to have the same rights as under present law. The lending institution making the original 7(a) guaranteed loan to the small business borrower would, as under present law, have the option of holding the loan or selling the guaranteed portion of the 7(a) loan into the secondary market by a sale of the loan either to an individual purchaser or to a broker or dealer interested in forming a pool of the entire guaranteed portions of numerous loans for resale.

The Committee's bill, H.R. 4773, would require SBA to develop procedures to promote secondary market operations. Moreover, in order to stress certain important aspects the Committee would establish some general, statutory guidelines on overall procedures to be followed by SBA.

To reduce paperwork and streamline procedures, SBA review of 7(a) guaranteed loan materials previously approved by the agency would be curtailed if the lender certifies that proper procedures have been followed.

Prepayment penalties on borrowers would not be permitted, and borrowers could pay their loans prior to maturity. By explicit statutory provision, H.R. 4773 would not affect an SBA loan recipient's prepayment, deferrment, or moratorium rights under the Small Business Act.

The bill would require SBA to contract with an agent (for a period not to exceed two years) to issue trust certificates and establish a central registration and information for all loans and trust certificates sold.

The Committee's bill, to safeguard investors, would require that any seller (excluding a lending institution originating the loan or a marketer of less than four loans per year) disclose to any purchaser of a loan or trust certificate information on the terms, conditions and yield of the loan or trust certificate. In this regard, the agency is also given authority to provide for regulation of broker/dealers in SBA guaranteed loans or trust certificates.

The bill would provide statutory deadlines for action by the agency. Within 90 days of enactment, SBA must issue regulations implementing the provisions on central registration of all SBA loans and trust certificates. Regulations implementing all other provisions of the Act are to be issued and finalized within nine months of enactment.

Provisions on pooling and sale of trust certificates could not be implemented until governing regulations are effective.

Finally, the bill would provide an extensive reporting requirement. By March 31 of each year, SBA would be required to report to the Small Business Committees of the Congress on the secondary market activity in SBA guaranteed loans for the preceding calendar year.

The bill would not authorize any funds to be appropriated.

Conclusion

Your Committee designed H.R. 4773 to give SBA statutory authority for its secondary market program instituted administratively in 1973, and to expand that program to permit the pooling of SBA guaranteed loans into larger lots for sale of fractional interest in such pools. This will encourage major brokers to participate in the program and facilitate the more efficient sale of guaranteed loans in the marketplace, without any additional cost to the Government. It also will attract larger institutional investment in SBA guaranteed loans, thereby encouraging investment in, and opening up new sources of capital for, small business. The legislation would insure greater efficiency and liquidity in the secondary market thereby increasing lender participa-

tion in the 7(a) program. The new market being established would provide small concerns increased access to capital at lower, fixed interest rates.

MATTERS REQUIRED TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clause 2(l)(2) of rule XI of the House of Representatives, the following statement is made relative to the vote on the motion to report H.R. 4773:

A majority of the Committee voted in person and was actually present and the motion was approved by a voice vote.

In compliance with clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the following statements are made:

With regard to subdivision (A), relating to oversight findings, the Committee finds, in keeping with clause 2(b)(1) of rule X, that this legislation is in full compliance with the provision of this rule of the House which states:

> In addition, each such committee shall review and study any conditions or circumstances which may indicate the necessity or desirability of enacting new or additional legislation within the jurisdiction of that committee. * * *

With regard to subdivision (B), relating to the statement required by section 308(a) of the Congressional Budget Act of 1974, the following statement is made relative to the legislation:

> Section 3(a)(2) of the Congressional Budget Act defines the term "tax expenditures" as those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion exemption, or deduction, from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.

None of the provisions of H.R. 4773 deals with taxation and thus, in your Committee's opinion, this bill does not provide new or increased tax expenditures.

Section 3(a)(2) of the Congressional Budget Act defines the term "budget authority" as authority provided by law to enter into obligations which will result in immediate or future outlays involving Government funds.

Under this definition, it is the final action of Congress that authorizes an agency to enter into obligations which constitutes new budget authority. In those cases which entail (1) an authorization for an agency to undertake a program; (2) an authorization for appropriation of funds to permit that agency to enter into obligations; and (3) an actual appropriation of such funds, it would be only the final action of Congress in appropriating funds which constitutes the budget authority.

None of the provisions of H.R. 4773 appropriates funds and thus, in your Committee's opinion, the bill does not provide new budget authority. Accordingly, no comparison of budget authority, outlays or tax expenditures or 5-year projections have been made.

With regard to subdivisions (C) and (D), the cost estimate of the Director of the Congressional Budget Office relative to H.R. 4773 follows:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C., June 20, 1984.

Hon. PARREN J. MITCHELL,
Chairman, Committee on Small Business, House of Representatives, Rayburn House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed H.R. 4773, the Small Business Secondary Market Improvements Act of 1984, as ordered reported by the House Committee on Small Business, June 19, 1984.

We estimate that enactment of this bill would cost the Federal government approximately $200,000 in fiscal year 1985 and less than $100,000 in each fiscal year thereafter.

H.R. 4773 would give statutory authority to the small business guarantee loan secondary market program instituted by the Small Business Administration (SBA) in 1972. The bill would require SBA to develop rules and regulations to implement the registration procedures, and to contract with an agent who would carry out the registration functions and issue trust certificates to facilitate pooling. It is expected that the agent would charge and collect fees for their services, with no cost to SBA.

H.R. 4773 would create no new liability on the part of SBA, but rather would facilitate the pooling of SBA guarantee loans by a private agent. The lender would remain obligated under its guarantee agreement with SBA, and would continue to service the loan. Because the bill would require the timely payment of principal and interest on the trust certificates issued by the designated agent, payments for defaults might be disbursed more quickly than under current practices. The timely payment provision may result in a one-time shift of a small portion of outlays for guarantee repurchases from fiscal year 1986 to 1985, although the total amount of repurchases is not expected to change. Beyond this initial shift, the pattern for disbursements for defaults would likely remain relatively constant.

It is estimated that SBA would incur costs of approximately $200,000 in fiscal year 1985 to issue rules and regulations; to consult with various federal, state, financial and other authorities; and to administer, promote, and report to the Congress on the secondary market operations. Once implemented, the annual cost to SBA is expected to be less than $100,000 annually. The bill does not authorize any additional appropriations to carry out the required activities.

Enactment of this bill would not affect the budgets of state and local governments.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

RUDOLPH G. PENNER,
Director.

No oversight findings or recommendations have been made by the Committee on Government Operations with respect to the subject matter contained in H.R. 4773.

In compliance with clause 2(l)(4), the Committee concludes that the provisions of this legislation in and of themselves will have no inflationary impact on prices and costs in the operation of the national economy.

In compliance with clause 7, rule XIII of the House of Representatives, The Committee makes the following statement:

The costs attributable to this bill for the current fiscal year and for fiscal years 1985–89 are as follows: This bill enlarges contingent Federal liability only by authorizing "timely payment" of principal and interest on SBA guaranteed loans as contrasted with current law which provides a guarantee on payment, but not timely payment. In addition, there will be some SBA manpower involved in developing and implementing the new loan pooling provisions. The bill, however, expressly provides that no additional authorization is being provided and your Committee expects that any additional costs attributable to this bill will be very minimal and will be covered under existing budget levels.

No cost estimate was submitted by any Government agency on H.R. 4773 to your Committee.

In your Committee's opinion, the above statements fully comply with the Rules of the House of Representatives.

Section-by-Section Analysis

Section 1 provides that this Act may be cited as the "Small Business Secondary Market Improvements Act of 1984."

Section 2 amends section 5 of the Small Business Act by adding a new subsection (f) which provides that the guaranteed portion of any loan made pursuant to the Small Business Act may be sold subject to the following:

A. if the lender certifies that the loan has been properly closed and that the lender has substantially complied with the provisions of the guarantee agreement and the regulations of the Administration, SBA shall review and approve only those materials not previously approved;

B. all fees due the SBA shall have been fully paid prior to sale; and

C. each loan shall have been fully disbursed prior to any sale.

The proposed paragraph (2) of the new subsection (f) provides that after a loan is sold in the secondary market, the lender shall continue to service the loan.

The proposed paragraph (3) of the new subsection (f) requires the SBA to develop procedures to promote secondary market operations and assess any increase in small business capital resulting from secondary market operations.

The proposed paragraph (4) of the new subsection (f) provides that nothing in this Act shall be interpreted to impede or extinguish the borrower's prepayment rights or any deferment or moratorium pro-

visions contained in sections 5(e), 7(a)(6) and 7(a)(8) of the Small Business Act.

Section 2 also proposes a new subsection (g). Under the proposed paragraph (1), the Administration is authorized to issue trust certificates representing ownership of all or a fractional part of the guaranteed portion of one or more of the SBA guaranteed loans except those loans issued pursuant to section 7(a)(13). The trust certificates would be required to be based on and backed by a pool of SBA guarantee loans.

The proposed paragraph (2) of subsection (g) authorizes SBA's Administrator to guarantee the timely payment of principal and interest on the trust certificates.

The proposed paragraph (3) of subsection (g) pledges the full faith and credit of the United States to the payment of all amounts required to be paid under the trust certificate.

The proposed paragraph (4) of subsection (g) prohibits SBA from collecting any fee for issuing the trust certificates.

The proposed paragraph (5) of subsection (g) provides that if SBA pays a claim under the trust certificates it is subrogated fully to the rights satisfied by the payment.

The proposed subsection (h) provides that upon the adoption of final rules and regulations, the SBA shall:

(1) provide for a central registration for the sale of all guaranteed loans and trust certificates including with respect to each sale, identification of each lender who has sold the loan; the interest rate paid by the borrower to the lender; the lender's servicing fee; whether the loan is for a fixed rate or variable rate; identification of each purchaser of the loan or trust certificate; the price paid by the purchaser for the loan or trust certificate; the interest rate paid on the trust certificate; the fees of an agent for carrying out the functions described in paragraph (2) below; and such other information as the Administration deems appropriate;

(2) contract with an agent to carry out on behalf of the Administration the central registration functions and the issuance of trust certificates to facilitate pooling. The agent is required to provide a fidelity bond or insurance in such amounts as the Administration determines to be necessary to fully protect the interest of the Government;

(3) prior to any sale, require the seller to disclose to any purchaser of a guaranteed loan and to any purchaser of a trust certificate information on the terms, conditions and yield of the instrument. If the instrument is a loan, however, no disclosure is required from the bank which made the loan or from any individual or entity which sells three or fewer loans per year.

Finally, a proposed paragraph (4) of the new subsection (h) gives SBA the authority to regulate brokers and dealers in guaranteed loans and trust certificates.

Section 3 requires SBA, within ninety days, to develop and promulgate final rules and regulations to implement the central registration provisions contained in the proposed section 5(h)(1), and to contract with an agent for an initial period of not to exceed two years to carry out the functions provided in the proposed section 5(h)(2).

It also requires SBA to develop and promulgate final rules and regulations to implement the other provisions of this Act within nine months.

Finally, section 3 prohibits SBA from implementing any of the provisions of the proposed section 5(g) until final rules and regulations become effective.

Section 4 amends section 10 of the Small Business Act by adding a new subsection (h) to require the administration to transmit, not later than March 31 of each year, to the Committees on Small Business of the Senate and House of Representatives a report on the secondary market operations during the preceding calendar year. This report is required to include, but is not limited to, (1) the number and the total dollar amount of loans sold into the secondary market and the distribution of such loans by size of loan, size of lender, geographic location of lender, interest rate, maturity, lender servicing fees, whether the rate is fixed or variable, and premium paid; (2) the number and dollar amount of loans resold in the secondary market with a distribution by size of loan, interest rate, and premiums; (3) the number and total dollar amount of pools formed; (4) the number and total dollar amount of loans in each pool; (5) the dollar amount, interest rate, and terms on each loan in each pool and whether the rate is fixed or variable; (6) the number, face value, interest rate and terms of the trust certificates issued for each pool; (7) to the maximum extent possible, the use by the lender of the proceeds of sales of loans in the secondary market for additional lending to small business concerns; and (8) an analysis of the information reported in (1) through (7) to assess small businesses' access to capital at reasonable rates and terms as a result of secondary market operations.

Section 5 amends section 4(c)(1)(B) and section 4(c)(2)(B) of the Small Business Act by inserting a reference to section 5(g) after the word sections.

Section 6 provides that this Act does not authorize the appropriation of any funds.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italic, existing law in which no change is proposed is shown in roman):

Small Business Act

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Sec. 4. (a) * * *

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(c)(1) There are hereby established in the Treasury the following revolving funds: (A) a disaster loan fund which shall be available for financing functions performed under sections 7(b)(1), 7(b)(2), 7(b)(3), 7(b)(4), and 7(c)(2) of this Act; and (B) a business loan and investment fund which shall be available for financing functions

performed under sections 5(g), 7(a), and 8(a) of this Act, and titles III and V of the Small Business Investment Act of 1958.

(2) All repayments of loans and debentures, payments of interest and other receipts arising out of transactions heretofore or hereafter entered into by the Administration (A) pursuant to sections 7(b)(1), 7(b)(2), 7(b)(3), 7(b)(4), 7(b)(5), 7(b)(6), 7(b)(7), 7(b)(8), 7(c)(2), and 7(g) of this Act shall be paid into a disaster loan fund; and (B) pursuant to sections 5(g), 7(a), 7(e), 7(h), 7(i), 7(l), and 8(a) of this Act, and titles III and V of the Small Business Investment Act of 1958, shall be paid into the business loan and investment fund.

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SEC. 5. (a) * * *

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(f)(1) The guaranteed portion of any loan made pursuant to this Act may be sold by the lender, and by any subsequent holder, consistent with regulations on such sales as the Administration shall establish, subject to the following limitations:

(A) prior to the Administration's approval of the sale, or upon any subsequent resale, of any loan guaranteed by the Administration, if the lender certifies that such loan has been properly closed and that the lender has substantially complied with the provisions of the guarantee agreement and the regulations of the Administration, the Administration shall review and approve only materials not previously approved;

(B) all fees due the Administration on a guaranteed loan shall have been paid in full prior to any sale; and

(C) each loan shall have been fully disbursed to the borrower prior to any sale.

(2) After a loan is sold in the secondary market, the lender shall remain obligated under its guarantee agreement with the Administration, and shall continue to service the loan in a manner consistent with the terms and conditions of such agreement.

(3) The Administration shall develop such procedures as are necessary for the facilitation, administration, and promotion of secondary market operations, and for assessing the increase of small business access to capital at reasonable rates and terms as a result of secondary market operations.

(4) Nothing in this subsection or subsection (g) of this section shall be interpreted to impede or extinguish the right of the borrower or the successor in interest to such borrower to prepay (in whole or in part) any loan made pursuant to section 7(a) of this Act or to impede or extinguish the rights of any party pursuant to sections 5(e), 7(a)(6), or 7(a)(8).

(g)(1) The Administration is authorized to issue trust certificates representing ownership of all or a fractional part of the guaranteed portion of one or more loans which have been guaranteed by the Admininstration under this Act, except those under section 7(a)(13): Provided, That such trust certificates shall be based on and backed by a trust or pool approved by the Administration and composed solely of the entire guaranteed portion of such loans.

(2) The Administration is authorized, upon such terms and conditions as are deemed appropriate, to guarantee the timely payment of the principal of and interest on trust certificates issued by the Administration or its agent for purposes of this subsection. Such guarantee shall be limited to the extent of principal and interest on the guaranteed portion of loans which compose the trust or pool. In the event that a loan in such trust or pool is prepaid, either voluntarily or in the event of default, the guarantee of timely payment of principal and interest on the trust certificates shall be reduced in proportion to the amount of principal and interest such prepaid loan represents in the trust or pool. Interest on prepaid or defaulted loans shall accrue and be guaranteed by the Administration only through the date of payment on the guarantee. During the term of the trust certificate, it may be called for redemption due to prepayment or default of all loans constituting the pool.

(3) The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guarantee of such trust certificates issued by the Administration or its agent pursuant to this subsection.

(4) The Administration shall not collect any fee for any guarantee under this subsection: Provided, That nothing herein shall preclude any agent of the Administration from collecting a fee approved by the Administration for the functions described in subsection (h)(2).

(5)(A) In the event the Administration pays a claim under a guarantee issued under this subsection, it shall be subrogated fully to the rights satisfied by such payment.

(B) No State or local law, and no Federal law, shall preclude or limit the exercise by the Administration of its ownership rights in the portions of loans constituting the trust or pool against which the trust certificates are issued.

(h) Upon the adoption of final rules and regulations, the Administration shall—

(1) provide for a central registration of all loans and trust certificates sold pursuant to subsections (f) and (g) of this section. Such central registration shall include, with respect to each sale, an identification of each lender who has sold the loan; the interest rate paid by the borrower to the lender; the lender's servicing fee; whether the loan is for a fixed rate or variable rate; an identification of each purchaser of the loan or trust certificate; the price paid by the purchaser for the loan or trust certificate; the interest rate paid on the loan or trust certificate; the fees of an agent for carrying out the functions described in paragraph (2) below; and such other information as the Administration deems appropriate;

(2) contract with an agent to carry out on behalf of the Administration the central registration functions of this section and the issuance of trust certificates to facilitate pooling. Such agent shall provide a fidelity bond or insurance in such amounts as the Administration determines to be necessary to fully protect the interest of the Government;

(c) prior to any sale, require the seller to disclose to a purchaser of the guaranteed portion of a loan guaranteed under this

Act and to the purchaser of a trust certificate issued pursuant to subsection (g), information on the terms, conditions and yield of such instrument. As used in this paragraph, if the instrument being sold is a loan, the term "seller" does not include (A) an entity which made the loan or (B) any individual or entity which sells three or fewer guaranteed loans per year; and

(4) have the authority to regulate brokers and dealers in guaranteed loans and trust certificates sold pursuant to subsections (f) and (g) of this section.

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SEC. 10. (a)* * *

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(h) The Administration shall transmit, not later than March 31 of each year, to the Committees on Small Business of the Senate and House of Representatives a report on the secondary market operations during the preceding calendar year. This report shall include, but not be limited to, (1) the number and the total dollar amount of loans sold into the secondary market and the distribution of such loans by size of loan, size of lender, geographic location of lender, interest rate, maturity, lender servicing fees, whether the rate is fixed or variable, and premium paid; (2) the number and dollar amount of loans resold in the secondary market with a distribution by size of loan, interest rate, and premiums; (3) the number and total dollar amount of pools formed; (4) the number and total dollar amount of loans in each pool; (5) the dollar amount, interest rate, and terms on each loan in each pool and whether the rate is fixed or variable; (6) the number, face value, interest rate and terms of the trust certificates issued for each pool; (7) to the maximum extent possible, the use by the lender of the proceeds of sales of loans in the secondary market for additional lending to small business concerns; and (8) an analysis of the information reported in (1) through (7) to assess small businesses' access to capital at reasonable rates and terms as a result of secondary market operations.

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